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ILLINOIS COMMERCE COMMISSION

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CITIZENS UTILITIES COMPANY OF ILLINOIS)
d/b/a CITIZENS WATER RESOURCES)

Petition for a Certificate of Public Convenience)
and Necessity to provide water and sanitary)
sewer service to parcels in McHenry County,)
pursuant to Section 8-406 of the Public Utilities)
Act; and for approval of a contract.)

Docket No. 00-0194

INITIAL BRIEF
OF CITIZENS UTILITIES COMPANY OF ILLINOIS

I. PROCEDURAL AND FACTUAL BACKGROUND

This proceeding involves Citizens Utilities Company of Illinois' ("Citizens") request, pursuant to Section 8-406 of the Public Utilities Act ("PUA"), 220 ILCS 5/8-406, that the Illinois Commerce Commission ("Commission") grant a Certificate of Public Convenience and Necessity authorizing Citizens to provide water and sanitary sewer services to various parcels located in McHenry County, Illinois. The area for which Citizens seeks certification is approximately 1,444 acres and is located within the corporate limits of the Village of Prairie Grove. Citizens Ex. 2.0 at 4 (Khan). Citizens further requests, to the extent necessary, approval of a related contract with Terra Cotta Realty Co. ("Terra Cotta").

Citizens is a public utility that currently provides water and/or sanitary sewer services to over 73,000 (approximately 39,000 water and 34,000 sewer) customer connections in six counties within northeastern Illinois. Citizens is a wholly-owned subsidiary of Citizens Communications Company, formerly known as Citizens Utilities Company, which directly or

through operating subsidiaries provides water, wastewater, electric, gas and/or communications services in more than 22 states throughout the United States. Citizens owns, operates and maintains water production wells, mains, hydrants, storage tanks and pumping stations, in addition to sanitary sewer collection systems, pumping stations, trunk sewers and sewage treatment plants. Citizens Ex. 2.0 at 4 (Khan).

Terra Cotta and its affiliates own (or owned) all the facilities which initially will serve the area for which Citizens is currently requesting certification. In preparation for initial phases of development in the area, Terra Cotta constructed a 500,000 gallon elevated water storage tank, two wells, a well house, and a lift station, along with water and sanitary sewer mains. Terra Cotta also owns a 100,000 gallon per day water reclamation facility ("WRF"). Citizens has entered into an Asset Purchase Agreement ("Agreement") with Terra Cotta to acquire these existing water and sewer facilities. In particular, these facilities initially will be available to provide water and sanitary sewer services to a new single family home development, a townhome development and a commercial development. Over the years, as development progresses, additional facilities may be required and they will be provided as needed. At this time, however, Citizens is not proposing any new water facilities. Planning for the WRF expansion is expected to commence in the year 2000. Citizens Ex. 1.0 at 3-4 (Scheppmann).

Citizens filed its Petition for a Certificate of Public Convenience and Necessity on February 25, 2000. The testimony of Reed Scheppmann and Bob Khan was filed on behalf of Citizens on March 29, 2000. The testimony of Theresa Ebrey and Roy A King, on behalf of the Staff of the Illinois Commerce Commission ("Staff"), was filed on May 24, 2000. Rebuttal testimony of Reed Scheppmann was filed on behalf of Citizens on June 9, 2000. Citizens filed a

Motion for Temporary Certificate of Public Convenience and Necessity on May 23, 2000, and the Motion was granted by the Commission on June 23, 2000. A hearing was held in this matter on August 1, 2000, at the Commission's Chicago office and the record was marked Heard and Taken on that date.

II. ARGUMENT

a. The Requirements for a Certificate of Public Convenience and Necessity Have Been Met.

The record establishes that the Section 8-406 requirements for a certificate have been met. Specifically, the evidence proves that: (1) Citizens' ownership, operation and maintenance of the water and sewer facilities is necessary to provide adequate, reliable and efficient water and sanitary sewer service to the customers to be located within the parcels for which certification is sought; (2) Citizens' ownership and operation constitutes the least-cost means of satisfying the service needs of those customers; (3) Citizens is capable of efficiently managing and supervising any activities necessary to serve all of the parcels; and, (4) Citizens is capable of financing the operations necessary to serve all of the parcels without adverse financial consequences to Citizens or its customers. Staff agrees that the above requirements of Section 8-406 have been met. Staff Ex. 2.0 at 5-7 (King).

Certifying Citizens to serve the area is necessary to provide adequate, reliable and efficient water and sanitary sewer service to the customers in the area. Presently, there is no other water or sanitary sewer utility providing the required service. Citizens Ex. 1.0 at 4 (Scheppmann). A Business Park (approximately 250 acres), a residential development (with approximately 97 homes), and a townhome development (with 170 townhomes) are planned for

the area, and property owners will soon need service within those developments. Tr. at 27; Citizens Ex. 1.0 at 4-5 (Scheppmann). Given that customers will soon need service and Citizens is the only utility ready, willing and able to provide such service, it is necessary and appropriate to grant Citizens a Certificate of Public Convenience and Necessity to serve the area.

Moreover, if a certificate is granted, Citizens will provide adequate, reliable and efficient service to the customers in that area, as it does to all its customers. Indeed, the existing facilities were designed, tested and inspected by professional engineers. As such, these facilities are sufficient to serve the initial phases of development in the area for which certification is requested. Citizens Ex. 1.0 at 5 (Scheppmann).

The record further establishes that certification of Citizens is the least-cost means of satisfying the service needs of customers to be located in the area for which certification is sought. Indeed, Citizens is virtually the only means of satisfying the service needs of customers in the area. Facilities are in place to serve the area currently being developed, and the owner of those facilities, Terra Cotta, already has entered into an agreement to sell those facilities to Citizens. It is obviously most cost efficient for Citizens, who already has an agreement to purchase the facilities, to provide service to the area. Allowing Citizens to serve the area avoids duplication of facilities and unnecessary costs. Moreover, because of the size and financial strength of Citizens, it possess economies of scope and scale lacking in smaller, stand-alone systems. These economies of scope and scale assure that certification of Citizens is the least cost means of satisfying the service needs in the area being developed. Additionally, the purchase of facilities is structured in a way which minimizes initial capital investment by Citizens and provides for investment to occur as new customers are connected. Significantly, the fact that the

Commission has jurisdiction over Citizens' rates and services provides assurance that Citizens will provide adequate, reliable and efficient service at the least cost. Citizens Ex. 1.0 at 5-6 (Scheppmann).

The record also establishes that Citizens is capable of efficiently managing, supervising and financing the activities and facilities necessary to serve all of the parcels without adverse financial consequences to Citizens or its customers. Indeed, Citizens possesses the managerial and technical expertise to provide service to the area for which certification is requested, as evidenced by its proven track record. Citizens currently services over 73,000 customer connections in six counties within northeastern Illinois and has many years of experience managing water and sanitary sewer facilities of this type. Citizens Ex. 1.0 at 6-7 (Scheppmann). Additionally, Citizens has access to all of the necessary funds to support this investment through its parent, Citizens Communications Company. Moreover, because of Citizens' financial strength, any required financing of future improvements or investment in facilities will not be a burden to Citizens or its customers. In short, neither Citizens nor its existing customers will be adversely affected by the purchase of the facilities at issue. Citizens Ex. 1.0 at 7 (Scheppmann).

As stated above, Staff witness Mr. Roy King agrees that the above requirements of Section 8-406 have been meet. Indeed, Mr. King testified that Citizens has demonstrated that the proposed construction is necessary to provide adequate, reliable and efficient service to customers and is the least-cost method of providing water and sewer service to the customers in the proposed area. Staff Ex. 2.0 at 6-7 (King). Mr. King also testified that Citizens is financially and operationally capable of providing service to the area, and that a public need exists for a certificate. Staff EX. 2.0 at 7 (King). Mr. King also inspected the area in question

and found that the water mains installed comply with 83 Ill. Adm. Code Part 600. Staff Ex. 2.0 at 8-9 (King). Notably, the area for which certification is requested is located within the corporate limits of the Village of Prairie Grove, and the Village supports Citizens' Petition for a Certificate of Public Convenience and Necessity. Citizens Ex. 1.0 at 4 (Scheppmann).

Because the requirements of Section 8-406 have been satisfied, the Commission should grant Citizens a Certificate of Public Convenience and Necessity to serve the parcels in question.

b. The Asset Purchase Agreement Between Citizens and Terra Cotta is Reasonable and Should be Approved by the Commission.

To the extent necessary, the Commission also should approve the Asset Purchase Agreement ("Agreement") between Citizens and Terra Cotta for the acquisition by Citizens of the existing water and sewer facilities. The Agreement, executed on February 16, 2000, was the result of arm's-length negotiations between Citizens and Terra Cotta, and represents the best interests of both parties. Indeed, both parties voluntarily entered into this Agreement under terms that were mutually satisfactory to each party. If the terms of the Agreement were not satisfactory, either party could have elected to abandon negotiations, or to negotiate with another party. The Agreement was entered into in good faith, is fair to both parties, and produces results that are in the public interest and serve the public convenience. Citizens Ex. 1.0 at 8 (Scheppmann).

More specifically, under the Agreement Citizens agrees to purchase and Terra Cotta agrees to sell, transfer, and convey all of the facilities on the Terra Cotta property except for the following: (1) two existing wells and any capped wells within Terra Cotta's manufacturing site and a 380,000 gallon water storage facility currently being used to provide water service to Terra Cotta's existing and future manufacturing facilities and administrative offices; and

(2) wastewater collection and pre-treatment facilities used to provide service to Terra Cotta's existing and future manufacturing facilities and administrative offices. Citizens Ex. 1.0 at 8-9 (Scheppmann).

The facilities being purchased include, but are not limited to, the following: two new wells and new well house, a 0.5 mg elevated storage tank, hydrants, meters, service lines, equipment, a generator, supplies, water mains, sanitary sewer mains, a new lift station, and an existing 0.1 mgd water reclamation facility and appurtenances. These facilities are suitable to provide service to the initial area being developed. The existing wells, mains and storage tank will provide water service to the Business Park and residential developments planned in the area. Citizens Ex. 2.0 at 5-6 (Khan).

With respect to capacity, the existing wastewater reclamation plant is rated at 100,000 gpd capacity. This plant has approximately 80,000 gpd available capacity. Terra Cotta has reserved in the contract 20,000 gpd for future flows for their facilities. As stated above, although this plant will be expanded to provide service to the area as customer growth occurs, for initial developments, Citizens does not intend to construct any facilities or drill any new wells, as the current facilities are capable of serving the initial developments planned in the area. Any future construction will be driven by future development requirements. Citizens Ex. 2.0 at 6 (Khan).

Under the Agreement, Citizens would reimburse Terra Cotta for water backbone plant based on new customer connections. Backbone plant includes the two new wells, well house, and the new 500,000 gallon elevated storage tank and related appurtenances. The amount of payment would be determined by the actual cost of the backbone facilities divided by the number of SFUs or PEs (determined by a professional engineer mutually agreed to by the parties) that can

be served by the backbone facilities. Citizens would reimburse Terra Cotta for the actual cost of the individual water service connections constructed by Terra Cotta between the water main and the property line. Citizens would pay to Terra Cotta 1 ½ times the first year water revenues of a typical residence for each new residential customer connected for the first time and in service for a period of one year. For new commercial customer connections, Citizens would pay to Terra Cotta 1 ½ times the actual first year's water revenue after the first full year of service. Citizens would make these payments for a period of ten years from the date of either the first customer connection or July 1, 2000, whichever occurs first. Citizens Ex. 1.0 at 9 (Scheppmann).

Citizens will not own the real estate on which the WRF facilities are located, but will own the WRF facilities. Terra Cotta and Citizens are entering into a lease agreement under which Citizens will lease the land on which the facilities are located from Terra Cotta for 99 years. The lease agreement contains a right of first refusal in the event that Terra Cotta receives a bona fide offer to purchase the premises during the term of the lease or any extension thereof. Citizens Ex. 1.0 at 10 (Scheppmann). Staff testified that the 99 year ground lease is reasonable. Staff Ex. 2.0 at 13-14 (King).

The financial arrangement under the Agreement complies with 83 Illinois Administrative Code 600.370 and Citizens' tariff does not prohibit a transaction of the type described in the Agreement. Indeed, Citizens' tariff contains no restrictive provision that would impact the terms of the Agreement. Citizens Ex. 1.0 at 10 (Scheppmann).

Staff agrees that the Agreement is reasonable for water facilities as it complies with Section 600.370. Staff Ex. 2.0 at 10-11 (King). However, Staff argues that the Agreement is not reasonable with respect to the sewer facilities because it does not include any refund

provisions to Terra Cotta for sewer facilities as customers are attached. Although Staff agrees that the developer should advance the funds for construction of the sewer backbone plant or construct the sewer facilities, Staff believes that the advances should be subject to refunds. Staff Ex. 2.0 at 11-12 (King).

Staff's argument lacks merit. Staff fails to reference any part of the PUA or the Commission rules that would require a sewer utility to make refunds as Staff suggests. Indeed, neither the Act nor the Commission rules impose any such requirement regarding financing or funding of sewer facilities, nor do Citizens' tariffs provide for refunds on sewer facilities. In fact, Staff has presented a similar proposal to the Commission in the past, and the Commission has rejected it. Specifically, in Docket No. 94-0481, Staff suggested that the water "main extension rule" also apply to the Company's sewer service. Citizens Utilities Company of Illinois, Ill. C.C. Docket No. 94-0481, 1995 WL 612576 * 13 (1995). The Commission rejected Staff's proposal, stating that, if a sewer main extension rule was to be developed, it should be done in the context of a generic hearing that would apply to all utilities. *Id.* at * 14. The Commission, however, has not proposed or adopted any such rules, even though it could do so if it thought appropriate.

In addition to having no basis in law, Staff's proposal would adversely affect Citizens and its customers, if adopted by the Commission. In particular, increased investment in sewer facilities would exert upward pressure on the rates charged to customers. In contrast, the negotiated Agreement with Terra Cotta will not put any pressure on rates due to increased investment. And, as a matter of policy, this type of cost benefits new development and should be borne by the developer.

Ironically, Staff admits that sewer utilities have been treated somewhat differently than electric and gas utilities due to the high level of investment per customer for sewer facilities (Staff Ex. 2.0 at 12 (King)); nevertheless, Staff overlooks this fact when presenting its refund proposal. Indeed, Staff's suggestion that Citizens will be acquiring "\$1,439,350 of sewer facilities, without making any investment in them," overlooks the significant investment Citizens makes in sewer facilities. The \$1,439,350 figure is gross sewer plant and only represents approximately 1.5% of the Company's \$94,018,482 in Gross Sewer Utility Plant In Service. The Company's Annual Report on file with the Commission reflects \$45,895,665 in Net book *cost* of sewer facilities. Clearly, Citizens is making a significant continuing investment in sewer facilities. Indeed, as Mr. Scheppmann clarified at hearing, Citizens invests a substantial amount of money in additions, rehabilitation and improvement of the facilities that it acquires. Moreover, Citizens does not earn a return on the gross utility plant, but only net plant. Tr. at 34.

Significantly, Staff also overlooks the fact that the Agreement between Terra Cotta and Citizens was the result of arms' length negotiations between two experienced parties. Citizens Ex. 1.0 at 8 (Scheppmann). Indeed, Terra Cotta and Citizens negotiated these terms over a period of time, and each party was represented by experienced business persons and legal counsel. Citizens Ex. 1.1 at 5-6 (Scheppmann). As noted above, if the terms of the Agreement were not satisfactory, either party could have elected to abandon negotiations, or Terra Cotta could have chosen to negotiate with another party. Citizens Ex. 1.0 at 8 (Scheppmann). Staff has presented no evidence to the contrary.

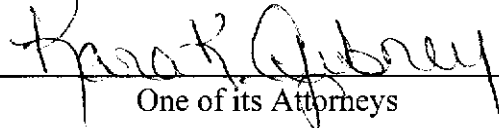
In short, the Asset Purchase Agreement between Terra Cotta and Citizens is reasonable and consistent with the Company's approved Tariffs and, to the extent necessary, should be approved.

III. CONCLUSION

As demonstrated above, the requirements of Section 8-406 have been satisfied, and the Asset Purchase Agreement between Terra Cotta and Citizens is reasonable. Therefore, the Commission should grant Citizens a Certificate of Public Convenience and Necessity and, to the extent necessary, approve the Asset Purchase Agreement between Terra Cotta and Citizens.

Respectfully submitted,

CITIZENS COMMUNICATIONS COMPANY
(f/k/a CITIZENS UTILITIES COMPANY OF ILLINOIS)

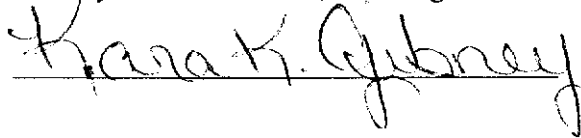
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CERTIFICATE OF SERVICE

I, Kara K. Gibney, hereby certify that on this 14th day of September, 2000, I caused the foregoing Initial Brief of Citizens Communications Company (f/k/a Citizens Utilities Company of Illinois) to be served on all parties listed below by either facsimile, messenger or U.S. mail.



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